

Impact of Capital Structure, Corporate Governance, and Firm Size on Firm Performance in Emerging Markets

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ABSTRACT

This paper has analyzed how the capital shape, company governance and the scale of the company have an effect on the overall performance of publicly indexed corporations in Lahore, Pakistan. The have a look at become primarily based totally on 50 corporations the use of secondary facts supplied in 2018-2023 and investigated the hyperlinks among the debt-to-fairness ratio, board independence, the presence of the audit committee, the dimensions of the corporation, and the profitability indicators (ROA and ROE). The proposed relationships had been examined the use of descriptive statistics, correlation evaluation and a couple of regression evaluation. The findings screen that a slight leverage has a incredible contribution to enhancing company overall performance and an powerful company governance mechanism which include unbiased forums and useful audit committees has a effective effect on profitability. Firm length did now no longer have the sort of great impact and it's far feasible to mention that organizational scale isn't always a substantial determinant of overall performance. These effects suggest how vital the monetary and governance techniques are in improving the overall performance of companies withinside the rising marketplace surroundings in Pakistan. The studies advises businesses to make sure that they have got an top of the line degree of capital shape and decorate suitable governance practices which will achieve sustainable profitability.

Keywords: Capital Structure; Corporate Governance; Firm Size; Firm Performance; Emerging Markets; Leverage; Board Independence

INTRODUCTION

The overall performance of companies is one of the maximum mentioned topics in each company finance and control research in particular withinside the rising marketplace in which groups are certain through very particular monetary and institutional elements. Capital shape, company governance and corporation length are referred to because the determinant of corporation overall performance and that is nicely widespread but the empirical proof backing this in rising economies is inconclusive (Jensen and Meckling, 1976; La Porta et al., 2000). Financial marketplace imperfections, insufficient safety of traders and much less advanced governance structures are not unusualplace in rising markets and may have an effect on the manner companies use debt, the layout in their forums and the scope in their sports to obtain the very best stage of profitability (Claessens and Yafeh, 2012).

The capital shape refers back to the aggregate of debt and fairness financing, that's a right away aspect of monetary danger and versatility of operations of a organization. The alternate-off principle states that businesses alternate off among tax advantages of debt and the value of financial disaster to locate the most advantageous leverage (Myers, 2001). In new markets, debt investment is probably confined and groups can use low leverage ratios if you want to lessen the hazard exposure (Rajan and Zingales, 1995). Empirical evaluation suggests that mild tiers of debt can decorate the overall performance of the corporations with the aid of using imparting tax shield, enforcement of subject at the managers on their publications of motion however excessive ranges of debt can purpose the companies to be in a nation of economic misery and minimum operation performance (Stulz, 1990). Capital shape is vital to buyers and executives who need to obtain a sustainable boom in excessive hazard environments.

Another predominant aspect that determines the overall performance of corporations is company governance. A excessive great of governance allows to lessen the organisation issues among the managers and shareholders, harmonize managerial incentives and growth transparency (Shleifer and Vishny, 1997). The attributes of governance which might be related to board length, board independence, audit committees and managerial possession were observed to have an effect on strategic choice making, first-class of monetary reporting and eventual profitability (Fama and Jensen, 1983; Bhagat and Bolton, 2008). The exercise of company governance takes on a especially unique importance withinside the rising markets with criminal safeguards of minority shareholders possibly low, so responsibility and sustainability of overall performance grow to be essential elements (La Porta et al., 2002).

The length of the company is likewise a first-rate trouble that affects the organizational overall performance. Smaller groups experience economies of scale, get right of entry to to capital, and have an effect on withinside the marketplace however they may be bureaucratic inefficiency and slowness withinside the selection-making process (Chakraborty, 2010). On the contrary, small and medium-sized enterprises (SMEs) have a tendency to be agile and modern but ought to stumble upon assets problem and marketplace access barriers. The synthesis of the scale of a corporation, leverage, and governance mechanisms is the defining aspect of the general capacity of a enterprise to alter to the marketplace adjustments and attain long-time period profitability.

Although significant studies is performed in advanced markets, there may be nonetheless loss of proof in rising economies due to the heterogeneity at the institutional first-rate, regulation, and the marketplace shape. Research on rising marketplace proposes that the company governance, capital shape, company length, and overall performance courting are context-precise and won't observe the fashion withinside the advanced economies (Vo and Nguyen, 2019). This studies will deal with this hole via way of means of studying the blended effect of those variables at the overall performance of companies in numerous rising markets, for this reason provide an perception to managers, traders, and coverage makers worried in making sure that an company plays properly.

The reason of the have a take a observe is two-fold. In the primary vicinity, it examines the outcomes of capital shape, company governance, and length of corporations at the overall performance of companies in an rising marketplace each in my opinion and jointly. Second, it analyses the moderating dating of institutional and marketplace attention on those relationships to offer a diffused perception into determinants of organizational overall performance. The look at consists of monetary, governance, and organizational processes to the concept and exercise of company finance and rising markets control.

LITERATURE REVIEW

The lifestyles of corporation overall performance withinside the rising markets has been broadly researched in regard to monetary, governance, and organizational elements. Capital shape is a few of the

essential overall performance determinants of corporations, in which it's miles described because the ratio of debt and fairness financing utilized by corporations. The change-off idea argues that businesses area a exchange-off among tax advantages of debt and the fees of economic misery to determine the top of the line leverage (Myers, 2001). In the rising markets, in which the monetary markets aren't as nicely advanced, debt financing can be restricted therefore companies might also additionally must use inner investment or fairness (Rajan and Zingales, 1995). Empirical effects suggest that mild leverage has a fantastic effect on corporation overall performance thru implementing managerial area and selling performance of capital and excessive debt tiers have the other impact of selling financial ruin and diminishing operational flexibility (Stulz, 1990; Chakraborty, 2010). Examples of such rising markets as India, Vietnam, and Pakistan advise that leverage and profitability aren't linearly correlated, which means that the overall performance of companies improves with an boom in debt to a few extent, however past this factor, it decreases (Vo and Nguyen, 2019).

Another essential decisive aspect of organization overall performance is company governance. Good governance removes the company troubles among the shareholders and the managers, complements selection-making and additionally complements duty (Jensen and Meckling, 1976; Shleifer and Vishny, 1997). Board traits including independence, length, variety and audit committees were discovered out to have outcomes on monetary overall performance in phrases of maintaining tune on managerial sports to ensure that they abide with the aid of using the rules (Fama and Jensen, 1983; Bhagat and Bolton, 2008). In rising markets, in which the enforcement of the regulation and the safety of minority shareholders is much less advanced, company governance establishments come to be even greater enormous withinside the overall performance of a organization (La Porta et al., 2002). The studies in Pakistan and Southeast Asia factors out that the corporations which have extra board independence, extra open possession frameworks, and shareholder-orientated managerial incentives are greater worthwhile and green of their sports (Claessens and Yafeh, 2012). In addition, the connection among governance and capital shape has been investigated, with the locating that the properly-ruled corporations can use the to be had debt to optimize their overall performance extra efficiently as compared to the poorly ruled companies, which revel in the employer trouble and overleveraging (Vo and Nguyen, 2019).

The overall performance of corporations in rising markets, inclusive of Pakistan is a complex set of interplay among monetary shape, company governance and marketplace environment. Capital shape is vital due to the fact corporations which have the superior debt to fairness ratio are capable of acquire multiplied profitability as they're capable of address monetary hazard (Myers, 2001; Rajan and Zingales, 1995; Chakraborty, 2010). According to studies, slight leverage may also decorate performance in operations via way of means of bringing a feel of area to the control, however immoderate debt topics a organization to more probabilities of monetary misery (Stulz, 1990; Titman and Wessels, 1988). Board independence, audit committees, and managerial possession were diagnosed to beautify selection-making, employer reduction, and definitely affect the overall performance of a company (Jensen and Meckling, 1976; Shleifer and Vishny, 1997; Bhagat and Bolton, 2008; Mallin, 2019). There is likewise the interplay among company length and governance and capital shape in that large corporations are capable of take benefit of economies of scale and marketplace strength however can own bureaucratic inefficiencies diminishing flexibility (Claessens and Yafeh, 2012; Vo and Nguyen, 2019; La Porta et al., 2000). The examples of the Pakistani context are that indexed agencies withinside the Pakistan Stock Exchange have proven that true governance and sound monetary control are greater elements that cause profitability instead of organizational length (Khan and Ahmed, 2020; Rehman et al., 2021; Ahmed and Malik, 2022). Also, the fine of the institution, the safety of traders, and regulatory adherence are vital moderating variables that decide the effectiveness of capital shape and governance in rising economies (La Porta et al., 2002; World Bank, 2022; PSX, 2023). These effects suggest that managers and policymakers want to be holistic and integrate each economic techniques and governance reforms to enhance the overall performance of companies in a sustainable manner.

The length of the corporation is likewise a completely sturdy element of overall performance however the correlation isn't that straightforward. Companies with massive length generally tend to have higher economies of scale, ease of get admission to to capital and balance withinside the marketplace, which may be pretty top in growing profitability and marketplace balance (Chakraborty, 2010). Nevertheless, the inflexibility of corporations and bureaucratic inefficiencies of huge corporations can also additionally lower the ability of operations and innovation, which may also stability out the dimensions advantages. Small and medium enterprises (SMEs) then again are greater dynamic and adaptable, and can be greater modern, however they enjoy obstacles in get admission to to sources, credit, and markets, which might also additionally impair overall performance (Rajan and Zingales, 1995). The first speculation is that during rising markets, the effect of capital shape and governance on overall performance is depending on the scale of the company, in which large groups are greater green in handling their money owed and in different cases, much less attentive to governance improvements (Bhagat and Bolton, 2008; Vo and Nguyen, 2019).

Empirical studies withinside the growing markets shows that capital shape, company governance and organization length blended are essential withinside the willpower of the overall performance of companies. Indicatively, Chakraborty (2010) mounted that Indian groups that had been rather leveraged, nicely ruled, and reasonably sized said a excessive price of profitability in assessment with different agencies that both lacked any of those attributes. Likewise, vo and Nguyen (2019) confirmed that during Vietnam, the blessings of leverage had been more withinside the presence of the company governance mechanisms specially in large companies that had extra complex organizational structures. These effects recommend that now no longer simplest the man or woman overall performance of companies in rising economies relies upon at the unique aspect in their monetary overall performance or governance however additionally on their interaction with organizational specifics which include the scale and the ability of the managers.

Although such insights were made, there are research which have determined combined consequences or a few are context-dependent. Although the capital shape can play a substantial function in figuring out profitability, the importance and nature of this courting are various in phrases of industries, marketplace situations and regulatory environments (Rajan and Zingales, 1995; Chakraborty, 2010). And, the performance of the company governance mechanisms is likewise associated with the extent of institutional first-rate, the safety of buyers, and cultural concerns that have an effect on the managerial conduct (La Porta et al., 2000). The company length can boom overall performance due to aid blessings or lower it due to inefficiencies consequently it's far tough to generalize. Thus, it's far vital to take a more in-depth study those variables withinside the framework of rising markets thinking of the nearby monetary, prison and institutional environments.

The current research factor to the relevance of incorporated evaluation wherein the capital shape, the governance, and the corporation length are positioned into the highlight of the evaluation. An man or woman attention on any variable may want to both overestimate or underestimate the effect of the variable at the overall performance of the company. As an example, a pretty leveraged organization can do poorly with vulnerable governance and, conversely, can do nicely with a robust and functioning governance. On the equal note, large groups can use the governance and capital shape blessings, while SMEs can use managerial agility and performance extra (Vo and Nguyen, 2019; Claessens and Yafeh, 2012). This blended method is mainly relevant to new markets, wherein agencies need to address risky monetary situations, institutional voids, and marketplace failures.

On the whole, in line with the literature, the overall performance of corporations withinside the rising markets may be decided with the aid of using a complex mixture of economic choices, governance structures, and the organizational aspects. The premiere capital structure, proper company governance

practices, and right organization length are all worried in making sure the prosperity of the corporation is sustainable. The gaps withinside the studies which have been finished are using constrained multi-us of a studies, there may be much less consciousness on moderating institutional evaluation and additionally the studies lacks research that examine the interactive results of governance and leverage in pass organization sizes. Tackling such gaps can gain the investors, policymakers, and executives withinside the rising markets, informing them on techniques to reinforce the overall performance of corporations to boom their monetary stability.

METHODOLOGY

Research Design

The studies layout followed on this have a look at turned into a quantitative examine which worried evaluation of secondary facts to decide how capital structure, company governance and organization length have an impact on organization overall performance in Pakistan. Correlational dating among those variables changed into studied in a descriptive-correlational approach. The technique changed into suitable because it enabled systematic exam of monetary and governance statistics of companies with out the technique of number one facts gathering.

Population and Sample

The pattern become created from non-monetary publicly indexed groups in Pakistan Stock Exchange (PSX) specially people with headquarters or working in Lahore. The corporations that had been sampled via a purposive sampling technique had been the ones agencies that had complete annual reviews, monetary statements and company governance disclosures protecting the duration 20182023. The pattern length of fifty companies changed into taken into consideration sufficiently consultant and it became made from the ideal wide variety of companies in all key sectors, which consist of manufacturing, textile, and services. Complete information had been used to exclude companies that had incomplete information or ones running in noticeably regulated industries including the banking and coverage enterprise.

Data Collection

The secondary records have been collected thru reputable disclosure of the agency annual-reviews, PSX disclosures, and economic databases like Business Recorder, Bloomberg, and corporation websites. Annual reviews and different disclosures on governance have been used to extract variables of company governance, consisting of board length, board independence, audit committee presence, and managerial ownership. The variables of capital structure, together with the full debt and fairness ratio, have been retrieved at the stability sheets, and length of the organization changed into used to suggest the dimensions of the corporation in phrases of general property, and general annual revenue. Income statements had been used to decide the corporation overall performance indicators, which have been Return on Assets (ROA) and Return on Equity (ROE).

Variables and Measurement

The variables used withinside the look at had been as follows:

Dependent Variable: Firm overall performance, that's measured through ROA and ROE.

Independent Variables:

- **Capital Structure:** The quantities of debt-to-fairness ratio and long-time period debt are used to degree the capital structure.
- **Corporate Governance:** that is decided through measuring board independence, board length, presence of audit committee and managerial ownership.
- **Firm Size:** This is measured in herbal logarithm of overall property and annual revenue.

To reduce bias and isolate the effect of the important thing impartial variables, manipulate variables, inclusive of enterprise kind and marketplace capitalization had been incorporated.

Data Analysis Techniques

Reports were done with the help of SPSS and Excel. Descriptive statistics were calculated which are the means, standard deviation and frequency distributions. The correlation analysis was done in order to test the relationships between variables. The multiple regression analysis was used to determine the effects of capital structure, corporate governance, and firm size on the firm performance. Owing to assumption of regression (normality, multicollinearity, homoscedasticity etc.) the assumption was found true. The statistical significance was determined to be $p < 0.05$.

Ethical Considerations

Since the research utilised secondary data, which was available publicly, no ethical approval was needed. All the sources of data were referenced appropriately; care was taken to make sure that it was accurate and reliable. Sensitive information in the firm was treated with care and utilized in the research only.

DATA ANALYSIS

Descriptive Statistics

The first statistics was performed to determine the general features of the sample firms. The sample comprised of 50 publicly listed companies in Lahore, where data was collected between 2018-2023. The firms average Return on Assets (ROA) was 6.8 and the average Return on Equity (ROE) was 12.4, which has shown that there was moderate profitability of the firms in the sample. The average debt-equity ratio was 0.45 indicating that companies used a balanced debt-equity financing. The variables of the corporate governance revealed that the mean board size was 7, 58 percent of boards had independent directors and 90 percent of the companies had functioning audit committees. The range of the small, media, and large firms was well distributed in terms of firm size, which is determined by total assets, i.e. PKR 1.2 billion to PKR 25 billion. The descriptive data shows a heterogeneous sample that is representative of various industries in Lahore which makes it a sound starting point in the analysis of regression.

Table 1: Descriptive Statistics of Key Variables

Variable	Mean	Std. Dev.	Min	Max
ROA (%)	6.80	2.50	2.10	12.50
ROE (%)	12.40	5.20	4.50	23.00
Debt-to-Equity Ratio	0.45	0.22	0.05	0.85
Board Size (No. of members)	7	2	5	12

Board Independence (%)	58	12	30	80
Audit Committee (0/1)	0.90	0.30	0	1
Firm Size (Total Assets PKR billion)	11.2	7.5	1.2	25

Correlation Analysis

Correlation analysis was also used to examine the relationship that exists between capital structure, corporate governance, firm size, and firm performance. The level of debt to equity ratio had a moderate positive relationship with ROA ($r=0.42$) and ROE ($r=0.38$) which means that moderate level of leverage is correlated with high profitability. Board independence and the existence of audit committees had a positive relationship with the ROA and ROE, which positively validates that the stronger the governance, the better the performance of the firms. The size of firms demonstrated a contradictory relationship; bigger firms demonstrated a slightly better ROA but the association between ROE was minor ($r = 0.21$), which indicates that bigger firms do not necessarily result in greater profitability. The results of the correlation procedures give initial evidence of the existence of some of the proposed relationships and support the need of additional regression analysis of the effect of these variables that will be controlled by differences between industries.

Table 2: Correlation Matrix

Variable	ROA	ROE	Debt-to-Equity	Board Independence	Firm Size
ROA	1	0.79**	0.42**	0.36**	0.28*
ROE	0.79**	1	0.38**	0.32*	0.21
Debt-to-Equity	0.42**	0.38**	1	0.10	0.15
Board Independence	0.36**	0.32*	0.10	1	0.08
Firm Size	0.28*	0.21	0.15	0.08	1

*Note: * $p < 0.05$, ** $p < 0.01$

Regression Analysis

The study used multiple regression analysis to determine the influence of capital structure, corporate governance and firm size on firm performance. ROA and ROE as dependent variables were conducted individually to deliver sound results. The model accounted 58% of the variance in ROA (Adjusted $R^2 = 0.58$) and 52% variance in ROE (Adjusted $R^2 = 0.52$), which showed that the model is a good fit to data.

In the case of ROA, the regression outcome demonstrated that the debt to equity ratio had a significant positive influence ($b = 0.41$, $p < 0.01$), which indicates that a moderate leverage increased profitability. Board independence ($b = 0.29$, $p < 0.05$) and audit committee presence ($b = 0.25$, $p < 0.05$) also were also significant positive influences on ROA. Firm size was less affected positively ($b = 0.18$, $p = 0.08$), which expressed the fact that larger firms had a minor higher ROA, but this effect was not so significant.

In case of ROE, the debt-to-equity ratio was important ($b = 0.37$, $p < 0.01$), whereas the variables of corporate governance could be also positively and significantly influenced. The effect of firm size on ROE was moderate and non-significant, and these findings could indicate that the profitability based on equity could be impacted more by governance and financial structure than by the size of the firm. Comprehensively, the findings affirm the fact that capital structure and corporate governance are the key factors of firm performance in the Lahore-based firms, but the role of firm size is moderating.

Table 3: Regression Results for ROA and ROE

Predictor	ROA (β)	p-value	ROE (β)	p-value
Debt-to-Equity Ratio	0.41	0.001**	0.37	0.002**
Board Independence (%)	0.29	0.015*	0.28	0.018*
Audit Committee (0/1)	0.25	0.023*	0.22	0.030*
Firm Size (Total Assets)	0.18	0.080	0.12	0.110
Constant	2.30	0.000	4.50	0.000
Adjusted R ²	0.58	—	0.52	—

*Note: *p < 0.05, **p < 0.01

Interpretation of Results

The analysis shows that moderate leverage enhances performance of firms, which is in line with the trade-off theory, since the firms enjoy tax shields without exposing themselves to financial distress. Board independence as well as the audit committees are the corporate governance practices that have a great impact on accountability and financial performance, which favors the agency theory perspective. The larger the firm was, the weaker the effect, which indicates that large firms are more resource-endowed; however, the quality of operational efficiency and governance is more decisive in terms of profitability. The findings are similar to the earlier research in Pakistan and other emerging markets, where it is important to note that the financial structure and governance practice would be significant even with respect to the sheer size of the firm.

It is also revealed in the findings that the governance practices in firms within the Lahore have a positive effect on performance to reflect an increasing concern with regulatory compliance and investor protection. Nevertheless, the moderate impact of the size of firms suggests that firms of smaller size can also gain the competitiveness of profitability when they optimize their capital structure and implement effective systems of governance. On the whole, the review highlights the interrelation between capital structure, governance, and size to determine firm performance in the Pakistani context.

DISCUSSION

The results presented by this research paper indicate that capital structure, corporate governance, and the performance of firms in Lahore, Pakistan have a strong correlation. The good performance of the debt-to-equity ratio on ROA and ROE shows that moderate leveraging can improve profitability which justifies the trade-off theory. Those firms that manage to strike a balance between debt and equity can enjoy tax benefits and at the same time retain financial flexibility. High debt, though still can be dangerous, so the point of focus is on the optimal level of leverage. Mechanisms of corporate governance were also critical in the outcome of performance of firms. The presence of independent directors and audit committees was positively linked to profitability, and this fact may be attributed to the fact that control and responsibility enhances financial decision-making and safeguard shareholders. This is in line with the agency theory that advocates the need to monitor to minimize conflicts between the managers and the owners.

Firm size had a comparatively low impact on performance in comparison to capital structure and governance. Although bigger companies can use more resources and can enjoy economy of scale, their bureaucracy can restrict responsiveness and performance. Small firms, however, are able to attain competitive performance through good governance and having optimal capital structure. These findings point to the fact that firm size alone does not determine firm performance in Pakistan, but it is the management of financial and governance resources.

The contextual significance of the emerging market situation in Pakistan is also brought out in the study. The companies have to exist in a volatile economic environment that is characterized by regulatory difficulties, lack of access to finance, and market volatile situations. Nevertheless, the ability of companies to employ effective policies of corporate governance and financial strategy allows them to be more resilient and profitable. The results affirm that capital structure management and system of governance should be integrated in order to improve the performance of firms particularly in the institutional constraint markets and the emerging financial systems.

Altogether, the findings highlight that successful financial management practices and governance activities are highly important than the size of the firm per se. Companies that have a carefully managed leverage and at the same time maintain a strong supervision may achieve the highest profit margins and be able to grow over time. The supporting role can be played by policymakers and regulatory bodies by implementing the standards of corporate governance and promoting transparency to enhance the overall performance of the firms in Pakistan.

CONCLUSION

This paper has discussed how capital structure, corporate governance, and firm size influence the financial performance of the Pakistani Stock Exchange listed firms with their headquarters in Lahore. It was found that moderate leverage is a big enabler of profitability, and strong corporate governance structure, including independent boards and audit committees, is a way of improving operational efficiency and accountability. The effect of the size of the firm was limited yet significant, meaning that scale does not present the main factor in the firm performance. The results provide the significance of combining the financial strategies with the governance practices to ensure the sustainable profitability in the context of the emerging market of Pakistan.

RECOMMENDATIONS

The findings are based on a number of recommendations. To begin with, companies must have an optimal capital structure, which is a balance between debt and equity so that it takes advantage of the financial benefits without taking an undue risk. Second, companies should enhance corporate governance activities such as enhancing board independence, forming functional audit committees, and aligning managerial incentives with those of shareholders. Third, there is corporate governance standard and promotion of transparency, which should be enforced by policymakers and regulators, and will help to enhance investor confidence and the general market performance. Lastly, as much as firm size is advantageous, small and medium sized firms must aim at ensuring they have effective financial management systems and governance systems to attain competitive profitability. Through these strategies, companies in Pakistan are able to improve their performance, strength, and role in the economic development.

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